Consultation on a Territorial System of Taxation

KPMG Response to Consultation

March 2022

KPMG

1 Stokes Place
St. Stephen's Green
Dublin 2
D02 DE03

1 Harbourmaster Place
IFSC
Dublin 1
D01 F6F5

Telephone +353 1 410 1000
Fax +353 1 412 1122
Internet www.kpmg.ie

Tom Woods
Head of Tax and Legal
t: +353 1 410 2589
e: tom.woods@kpmg.ie

Brian Daly
Partner, Tax
t: +353 1 410 1278
e: brian.daly@kpmg.ie

Gareth Bryan
Partner, Tax
t: +353 1 410 2434
e: gareth.bryan@kpmg.ie

Consultation on Territoriality,
Tax Division
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2
D02 R583

Email: intltax@finance.gov.ie

7 March 2022

Dear Sir / Madam

Consultation on a Territorial System of Taxation

KPMG is pleased to respond to the consultation on territoriality. KPMG is the largest provider of business taxation advice in Ireland. We have drawn on our experience of providing advice to businesses across a range of sectors to provide comments to the consultation.

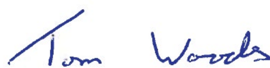
Ireland must continue to provide a competitive tax offering to encourage both foreign direct investment into Ireland and facilitate growth of Irish indigenous businesses. In light of international tax developments and adoption of these measures into the Irish corporate tax regime, we would recommend that Ireland introduce a participation exemption and a foreign branch exemption. These exemptions will reduce the compliance burden for Irish based business with foreign operations and bring Ireland in line with many other countries in Europe who have such regimes.

In addition, Ireland should take this opportunity to simplify the existing double tax credit regime for those not availing of the exemptions.

The contact point for this submission is Gareth Bryan. Gareth Bryan's contact details are: Email: gareth.bryan@kpmg.ie ; Direct telephone: (01) 410 2434.

Should you wish to discuss any aspect of the attached submission please do not hesitate to contact us.

Yours faithfully



Tom Woods

Partner

Executive Summary

Ireland should introduce both a participation exemption and a foreign branch exemption. This should be offered on an election basis at the choice of the taxpayer.

Ireland should take the opportunity to simplify the double tax credit regime contained in Schedule 24, Taxes Consolidation Act 1997.

These changes should be implemented in tandem with the introduction of any rules pertaining to the global minimum effective tax rate under OECD BEPS 2.0 Pillar Two GloBE rules.

In light of recent international tax developments, Ireland must remain an attractive location both for Irish domestic enterprises seeking to expand internationally and for foreign direct investment seeking a base in the European Union (EU).

The worldwide taxation regime with credit given for underlying foreign taxes is administratively burdensome to comply with.

Predominately, EU countries have participation exemptions for foreign dividends and many of our key competitor countries have introduced an exemption for foreign branch profits.

The greatest benefit received from adopting a territorial regime for the taxation of foreign branch profits and foreign dividends is one of greater simplicity in the application of the corporation tax regime. Businesses and Revenue alike can benefit from reduced administrative complexity and greater certainty arising on the amount of Irish tax payable on these profits.

Insofar as there are concerns that a participation regime could facilitate base erosion or profit shifting, anti-tax avoidance measures, many of which have been introduced via the implementation of BEPS Actions Items can protect against this risk, and we have identified some changes that could be made to some of these measures to coincide with the introduction of the participation exemptions.

In addition, there is a logic and benefit to introducing a participation exemption for foreign dividends and branch profits concurrently with the introduction of a minimum level of tax under OECD BEPS 2.0 Pillar Two. Firstly, it will avoid the imposition of multiple levels of taxation on the same underlying profits which will have been subjected to at least the minimum level of tax. It will also assist international focussed groups who are considering what restructuring they may need to do on foot of the BEPS proposals to understand the benefits of establishing or retaining Irish entities in their structure.

Along with the introduction of these exemptions, we consider it is an appropriate time to review certain aspects of the existing substantial shareholding exemption on gains to align

the eligibility criteria with the dividend participation exemption and international tax developments. In these respects, our existing regime is not as generous as those which apply in a number of other key EU countries and also the UK.

Recommended eligibility criteria:

Outlined below are the eligibility criteria we recommend for the dividend participation exemption, the foreign branch exemption and a revised substantial shareholding exemption.

Dividend participation exemption

- ✓ **5% ownership** – the ownership test should be by reference to the ordinary share capital, entitlement to profits and to assets on a winding up of the total share capital of the company.
- ✓ **Minimum holding period** – we note that several other countries have a minimum holding period requirement. Any holding period requirement should be aligned with the holding period requirement in the substantial shareholding exemption. It will be important that it is clear that the participation exemption will apply from the date of ownership provided the shares are ultimately held for the minimum holding period.
- ✓ **Qualifying jurisdictions** –
  - Companies within the scope of GloBE should be eligible for the exemption regardless of the location of the payor.
  - Companies outside of GloBE should be eligible for the exemption where the payor is located in a jurisdiction which is not included on the EU non-cooperative list. In assessing whether the dividend is paid by a company located in a qualifying jurisdiction, the dividend should be capable of being tracked through any number of intermediary layers.
- ✓ **Classes of shares** – the exemption should apply to distributions on all classes of shares.
- ✓ **Distribution on shares** – the exemption should apply to all income type distributions on shares and not be confined to dividends.
- ✓ **Denied where tax deductible** – the participation exemption should not be available where the payor secures a tax deduction for the distribution.
- ✓ **No foreign tax relief for withholding taxes** – relief should not be available for foreign withholding taxes on distributions availing of the participation exemption.
- ✓ **No trading test requirement** – it should not be a requirement to satisfy a trading test in order to avail of the exemption.
- ✓ **Ability to elect out of the exemption** – the exemption should be the default outcome where the relevant conditions are satisfied. However, taxpayers should retain the right to elect out of the exemption applying with regard to specific dividends.

Foreign branch exemption

- ✓ **Qualifying jurisdictions** –
  - Companies within the scope of GloBE should be eligible for the foreign branch exemption regardless of their location.
  - For companies outside of GloBE, they should be eligible for the foreign branch exemption where the branch is located in a jurisdiction which is not included on the EU non-cooperative list.
- ✓ **Trading test** – the exemption should only be available for branches whose activities constitute the conduct of a trade. This will assist in minimising any potential complications with our double taxation agreements.
- ✓ **Taxable presence** – the branch must have a taxable presence in the jurisdiction in which it is located.

- ✓ **Income and gains** – the branch exemption should extend to all branch trading profits, including those in the character of both income and capital gains.
- ✓ **Cessation and post cessation receipts** – the branch exemption should apply to profits arising on sale of the branch business or on the unwind or cessation of the branch's business, as well as post cessation trading related receipts.
- ✓ **No foreign tax relief** – relief should not be available for foreign taxes on branch profits where the exemption regime applies to the branch.
- ✓ **Election basis** – we recommend the taxpayer should be able to make a revocable election to apply the branch exemption on a branch-by-branch basis.
- ✓ **Losses** – in circumstances where branch losses have been used to obtain Irish tax relief, a branch exemption for profits would not be available until such time as the taxable amount of branch profits equals the amount of Irish taxable profits which have been reduced using branch losses. This rule should also apply to losses emerging prior to the introduction of the regime.
- ✓ **Transparent entities** – provide certainty that corporate partners in a tax transparent entity can avail of the branch exemption on its share of the foreign branch profits.

Substantial shareholding exemption

- ✓ **Qualifying jurisdictions** –
  - For companies within the scope of the GloBE rules, we should extend the definition of 'relevant territory' so that the relief applies irrespective of the location of the investee company.
  - Companies outside of GloBE should be eligible for the exemption where the investee company is located in a jurisdiction which is not included on the EU non-cooperative list.
- ✓ **No trading test requirement** – amend the relief by removing the trading test requirement.
- ✓ **Holding period** – any holding period requirement should be aligned with the holding period requirement in the participation exemption. Clarity that the substantial shareholding exemption will apply from the date of ownership provided the shares are ultimately held for the minimum holding period will be important.

Summarised below are additional points that will need to be considered on foot of the introduction of a dividend participation exemption and foreign branch exemption and in light of changes to the international tax environment.

CFC charge

On foot of the introduction of a foreign branch exemption, the CFC rules should be amended to bring foreign branches availing of the exemption within scope of the CFC charge.

Interest deduction for funding costs of investment

We do not consider that any further restrictions to our existing rules dealing with deductibility of interest and financing costs should be introduced on foot of the introduction of a foreign branch exemption and a participation exemption.

Exit Tax

An amendment to the current exit tax rules should be made to capture a transfer of assets between head office and branch where Ireland would not retain taxing rights over the transferred asset.

Simplifying the existing double tax credit regime

Simplification of the existing double tax credit regime is highly recommended. It has become very complicated and can give rise to costly compliance costs and unanticipated outcomes.

The regime will continue to be important for those taxpayers in receipt of royalties, interest, lease rental income, gains etc as well as for those who elect out of the dividend and branch exemptions regime.

Hybrid provisions

We do not believe that Ireland's Anti-Hybrid rules will need to be amended if a foreign branch and participation exemption is introduced.

OECD BEPS 2.0 Pillar Two – GloBE rules

The introduction of a participation exemption and foreign branch exemption will simplify the avoidance of multiple levels of taxation on the same underlying profits which will have been subjected to at least the minimum level of tax under OECD BEPS 2.0 Pillar Two principles. For in scope multinationals, aligning the Irish corporation tax regime with the GloBE rules will facilitate ease of administration and remove unnecessary complexity.

Double Tax Treaties

A participation exemption and a foreign branch exemption can be introduced solely through changes in domestic legislation alone. Save for possibly having to adopt Article 10 of the Multilateral Instrument in respect of foreign branches, no changes would be required to our treaties as the exemptions would not give rise to income being taxed in both countries. In order to avoid having to potentially adopt Article 10, we recommend that the Irish foreign branch exemption is only available to trading branches.

1. Policy Benefits of Participation Exemption and/or Branch Exemption Regimes

Question 1

What is your opinion of Ireland's corporate tax potentially moving from the current worldwide system with credit relief for foreign tax to a territorial system of double taxation relief, including participation exemption and/or branch exemption provisions?

Ireland should introduce both a participation exemption and a foreign branch exemption. This should be offered on an election basis at the choice of the taxpayer. In addition, Ireland should take the opportunity to simplify the double tax credit regime contained in Schedule 24, Taxes Consolidation Act 1997.

In light of recent international tax developments, Ireland must remain an attractive location both for Irish domestic enterprises seeking to expand internationally and for foreign direct investment seeking a base in the European Union.

The current worldwide taxation regime with credit given for underlying foreign taxes is administratively burdensome to comply with. Such complexity acts as a barrier for both investment into Ireland but also for indigenous businesses seeking to expand operations outside of Ireland. These exemptions will reduce the compliance burden for Irish based business with foreign operations and bring Ireland in line with many other countries in Europe who have such regimes.

The greatest benefit of adopting a territorial regime for the taxation of foreign branch profits and foreign dividends is one of greater simplicity in the application of the corporation tax regime. Reduced complexity for business in the operation of the regime should reduce the barriers to conducting business internationally from an Irish base which arise where a regime is complex to administer. Businesses and Revenue alike can benefit from reduced administrative complexity and greater certainty arising on the amount of Irish tax payable on these profits.

Whilst the move to a participation and foreign branch exemption can, on the face of it, give rise to additional risk of base erosion and profit shifting, several of the measures already introduced to the Irish corporate tax regime in recent years provide sufficient protection against these risks. In particular we would refer to the new Controlled Foreign Company rules, the Exit Tax rules, the implementation of the new transfer pricing rules for attribution of profits to branches and the imminent introduction of OECD BEPS 2.0 proposals. We have

identified some changes that could be made to the CFC and exit tax provisions to take on board the implications of introducing these exemptions.

The introduction of a participation exemption and a foreign branch exemption are only two elements of a territorial regime. Ireland will continue to tax all other elements of foreign profits of Irish resident companies. In this regard Ireland should simplify the current double tax credit regime contained in Schedule 24 for dividends and foreign branch profits which remain outside the dividend participation and foreign branch exemption regime, and for income and gains not eligible for the participation regime such as gains, leasing income, royalties, interest income, etc. The existing regime is unduly complex and costly to administer.

Question 2

What would the broad benefits be for multi-national enterprises if Ireland were to move to such a system?

The greatest benefit we see from moving to adopt a territorial regime for the taxation of foreign branch profits and foreign dividends for multinational enterprises is one of greater simplicity for business together with greater certainty arising on the amount of Irish tax payable on these profits.

In addition, given that so many other countries, in particular in Europe, have dividend and foreign branch exemptions, the regimes are more readily understood by multi-national enterprises operating in several jurisdictions than a worldwide taxation system affording relief by way of credit.

Having these exemptions available in Ireland will therefore make Ireland more attractive as a location of choice for groups looking to

- **centralise their international or regional shareholdings under an Irish company,**
- **conduct their international business on a branch basis from an Irish Headquarters.**

Foreign Dividends:

Ease of administration, a clear understanding of the tax regime and certainty in its operation are key deciding factors when businesses are choosing a location to invest in.

Foreign dividends are subject to corporation tax at either the 12.5% or 25% rate of tax depending on certain conditions and taxpayer elections. Credit relief against Irish corporation tax on dividends is available both for foreign withholding taxes deducted on payment of the dividend as well as corporate income taxes paid on the profits from which the dividend is paid. Through a combination of double tax credit relief which is afforded under Ireland’s double tax treaties as well as unilateral relief provisions, it would be unusual for Irish companies to pay corporation tax on receipt of foreign dividends. This is because the rate of foreign tax credit relief is generally higher than the Irish attributable tax. However, due to the way the rules work there is considerable complexity and costs associated with administering (tracking, tracing and related record keeping) and calculating the credit relief entitlement (in no small part due to the fact that these rules have been built up over many years). While the

effect of the rules is that, in many cases, there is a *de facto* exemption from tax, the complexity of the computational rules acts as a barrier to the use of Ireland as a hub or central location either for the conduct of business through foreign subsidiaries or through foreign branches.

Foreign Branches:

Multinational enterprises frequently operate through branches (in preference to subsidiaries) e.g. to take advantage of regulatory optimisations, such as the ability to 'passport' a recognised regulatory status from one EU Member State while conducting business in another Member State. These practices are commonly found in sectors such as insurance and banking but can also be found in unregulated sectors.

For the reasons outlined below a country with a foreign branch exemption regime is likely to present its taxpayers with less barriers to the conduct of business in new markets through branches than a regime which imposes a more complex worldwide taxation regime with credit relief.

Significant differences can arise in the timing and measure of taxable income (or the deduction of regulatory reserves) when comparing one country's corporate income tax regime to another[1]. These differences do not pose any specific issues for taxpayers based in countries that offer a branch exemption regime. However, for businesses based in Ireland, they can cause considerable uncertainty as to whether sufficient credit relief will be available for foreign taxes at a time when the related income and/ or expense is recognised for Irish tax purposes.

Removing this complexity will allow Irish based businesses to compete on equal terms with businesses headquartered in EU Member States that operate a branch exemption regime.

Another benefit from introducing a branch exemption regime in addition to an exemption regime for foreign dividends is that it will equalise more closely the Irish tax position in relation to profits arising from the conduct of foreign business through a branch instead of through a subsidiary. At present, branch profits are taxed as they arise whereas taxpayers may benefit from a significant deferral of taxation on the profits arising in a foreign subsidiary. Equalising the tax position of business conducted through branches with that of subsidiaries is more the norm throughout the EU. It reduces the potential for discrimination to arise where taxpayers choose to conduct business through branches instead of subsidiaries.

OECD BEPS 2.0:

As businesses seek to reorganise their business structures on foot of the complexity arising from applying the OECD BEPS 2.0 rules to several jurisdictions, Ireland should contemporaneously introduce the foreign branch and participation exemption with the OECD BEPS 2.0 Pillar Two global minimum effective tax rate. Businesses are assessing the additional complexity, administrative burden and risk of significant tax disputes arising from the implementation of OECD BEPS 2.0 rules. In assessing whether to have a presence in a location or to centralise several business activities into one jurisdiction, ease of tax administration will be a persuasive factor. Clearly signalling that Ireland will introduce a

[1] Sometimes this arises because branch accounts are required in the branch jurisdiction to be prepared using local GAAP which may differ from the FRS 102/IFRS accounting standards usually adopted by Irish companies. There are also usually timing differences as to when tax is paid on branch profits and losses are relieved.

foreign branch and participation exemption will be helpful in positioning Ireland as a location of choice in this environment.

Question 3

Are there any particular drawbacks or concerns for multi-national enterprises which should be considered if Ireland were to move to such a territorial system of double tax relief, including any indirect consequences or risks?

For most multinational enterprises, the introduction of a participation exemption and a foreign branch exemption will be welcome. However, as is outlined in further sections below, certain enterprises may wish to continue with the worldwide taxation regime so as not to be economically worse off. These include:

Participation exemption

- Where a foreign subsidiary is a CFC, in determining the CFC charge, the undistributed profits of the CFC can be reduced by 'relevant distributions', being dividends taxed in Ireland. Hence, companies may elect out of the participation regime in order to reduce their CFC charge.

Foreign branch exemption

- Businesses familiar with the current taxation of foreign branches may have a preference to retain the current method of taxation rather than apply the CFC provisions.
- Where the branch is loss making, head office companies may seek to utilise the losses in the branch under the worldwide tax regime. (Note : we are suggesting that rules would be introduced so that where branch losses have been used to obtain Irish tax relief, a branch exemption for profits would not be available until such time as the taxable amount of branch profits equals the amount of Irish taxable profits which have been reduced using branch losses).
- Where the exit tax arises on the transfer of assets from a head office to a foreign branch availing of the foreign branch exemption, certain companies will not be in a position to pay the exit tax arising on transfer. Instead of triggering a taxable event and related cash tax cost when transferring the assets to the branch, the company may prefer to tax the branch on its profits under the current worldwide tax regime.
- Where a potential risk of a CFC charge could arise in respect of exempt foreign branch profits, businesses may prefer to tax the foreign branch profits under the current worldwide regime and claim a foreign tax credit in respect of branch profits.

Question 4

Are there particular examples of best practice associated with a change to territoriality in other jurisdictions which could be considered, with a view to reducing compliance burdens without increasing avoidance risks?

Several of the measures introduced by way of the EU Anti-Tax Avoidance Directive safeguard against base erosion where a participation and a foreign branch exemption exist. As outlined in sections below, further consideration should be given to changes to the CFC regime and the Exit tax regime in this regard. Therefore, introducing the proposed partial territorial system of taxation should not increase avoidance risks and should reduce the compliance burden on both taxpayers and Revenue.

2. Scope of Exemption Regimes

Question 5

Taking account of the above, what in your view would be the potential impacts of moving to a participation exemption regime as set out in the Coffey Report?

Question 6

Are there particular considerations or design features that should be considered in reviewing the basis of the Irish corporation tax system?

Question 7

Taking account of, but not limited to, the design elements above, what in your view would be the best regime for Ireland to transition to, should a change take place? Please elaborate with consideration of the impacts, benefits and potential drawbacks both of (a) your preferred approach and (b) any approaches which you do not think would be beneficial.

Outlined below we recommend the eligibility criteria to avail of a dividend participation exemption and a foreign branch exemption. Along with the introduction of these exemptions, we consider it is an appropriate time to review certain aspects of the existing substantial shareholding exemption on gains and align the eligibility criteria with the dividend participation exemption and international tax developments. In these respects, our existing regime is not as generous as those which apply in a number of other key EU countries and the UK.

In outlining our recommendations on the exemption criteria, we have taken into consideration the comments included in the 2017 Coffey Report and features of similar regimes in other countries.

Dividend participation exemption

- **5% ownership** – In line with the substantial shareholding exemption for gains in Section 626B, Taxes Consolidation Act 1997 apply the exemption to dividends where the Irish resident company has a direct or indirect holding of shares in the company from which the dividend is ultimately sourced by virtue of which (alone or in concert with other group members[2]) it holds / is entitled to at least 5% of the ordinary share capital, profits and assets on a winding up (i.e. aligned with the substantial shareholding exemption).
- **Minimum holding period** – We note that several other countries have a minimum holding period requirement. Any holding period requirement should be aligned with the holding period requirement in the substantial shareholding exemption. It will be important that it is clear that the participation exemption will apply from the date of ownership provided the shares are ultimately held for the minimum holding period (as otherwise dividends received early during the life of the investment might be inadvertently outside the scope of the exemption).

[2] See group ownership provisions in Section 626B, Taxes Consolidation Act 1997

- **Qualifying jurisdiction** –

  For companies within scope of GloBE / EU rules on minimum tax:

  To align with the OECD BEPS 2.0 Pillar Two GloBE rules as applied within the EU, which will see all profits, irrespective of location, being taxed at a minimum rate via the Income Inclusion or Under-taxed Payment Rule, companies within scope of the GloBE rules should be eligible for the participation exemption irrespective of the location of the payor. We recommend that this should also be applied to the substantial shareholding exemption, under Section 626B, Taxes Consolidation Act 1997.

  For companies not within scope of GloBE / EU rules on minimum tax:

  In order to be sufficiently attractive as compared to the regimes in place in other countries, whilst the list of qualifying countries should include all EEA countries and our Treaty partners, it should be wider than this. It should extend to all jurisdictions except those included on the EU non-cooperative list.

  If the list is to be confined further, it could include EEA countries and our treaty partners alongside;

  - all countries that have signed up to the Convention on Mutual Administrative Assistance in Tax Matters excluding those on the EU non-cooperative list
  - all countries in the Inclusive Framework who have signed up to the OECD BEPS 2.0 Pillar Two Plan, provided the countries are not on the EU non-cooperative list

  In determining the 'location' of the company, this should be linked to where the company is either resident, managed and controlled or incorporated. Confining the list to those tax resident in a jurisdiction results in several jurisdictions not being eligible as they do not have a concept of tax residence. Instead, they may tax by reason of domicile, place of management, incorporation or any other criterion of a similar nature. Often countries with an exclusively territorial tax regime will not have adopted a concept of tax residence.

  It will be important that the dividend can be tracked through any number of intermediary layers of companies to determine that it is paid by a company located for tax purposes in a qualifying jurisdiction.

  The list of qualifying jurisdictions eligible for substantial shareholding exemption should be amended to align with the qualifying jurisdictions for the dividend participation exemption.

- **Classes of shares** – The exemption should apply to distributions on all classes of shares, including preference shares (subject to the possibility that the above-mentioned ownership criteria might require the recipient (or the group of which it is part) to hold some ordinary shares).

- **Distribution on shares** – The exemption should apply to all income type distributions on shares and not be confined to dividends.

- **Denied where tax deductible** – A dividend exemption should not be available where the payor has secured a tax deduction for the distribution. This is aligned with the approach to hybrid mismatches which Ireland is obliged to adopt under ATAD.

- **No tax relief on withholding taxes** – Tax relief would not be available for taxes borne on payment of the distribution or on taxes borne on the profits from which the distribution is paid.

- **No trading test requirement** – We do not consider that a trading test should be required to be eligible for the exemption. This is in recognition that dividends can arise from holding companies which may or may not be carrying on an active trade and the fact that trying to trace the ultimate source of profits through many layers with amounts coming from potentially many indirect subsidiaries in many countries, would be extremely difficult and, in many cases, entail a somewhat arbitrary apportionment as to which dividends were sourced from which activity. This proposed approach is in line with the current domestic exemption for Franked Investment Income where no distinction is made. In addition to denying relief where a tax deduction is available, we consider that existing anti-avoidance measures, including access to tax treaties, CFC charge, the OECD BEPS 2.0 minimum effective tax rate, transfer pricing, etc. already afford the protections to guard against risk of tax avoidance. We note that internationally, several jurisdictions operate their exemption without a trading test.
- **Ability to elect out of the exemption** – The exemption should be the default outcome where the relevant conditions are satisfied. However, companies should be entitled to elect not to apply the exemption in respect of specific dividends, at the choice of the taxpayer.

Foreign branch exemption

- **Qualifying jurisdictions** – Similar to the dividend participation exemption, the definition of qualifying jurisdictions for the foreign branch exemption should be delineated for companies within scope of GloBE and those outside the scope of GloBE.

  For companies within scope of GloBE / EU rules on minimum tax:

  To align with the OECD BEPS 2.0 Pillar Two GloBE rules as applied within the EU, which will see all profits, irrespective of location, being taxed at a minimum rate via the Income Inclusion or Under-taxed Payment Rule, companies within scope of the GloBE rules should be eligible for the foreign branch exemption irrespective of the location of the foreign branch.

  For companies not within scope of GloBE / EU rules on minimum tax:

  In order to be sufficiently attractive as compared to the regimes in place in other countries, whilst the list of qualifying countries should include all EEA countries and our Treaty partners, it should be wider than this. It should extend to all jurisdictions except those on the EU non-cooperative list.

  If the list is to be confined further, it could include EEA countries and our treaty partners alongside;

  - all countries that have signed up to the Convention on Mutual Administrative Assistance in Tax Matters excluding those on the EU non-cooperative list
  - all countries in the Inclusive Framework who have signed up to the OECD BEPS 2.0 Pillar Two Plan, provided the countries are not on the EU non-cooperative list
- **Trading test** – The branch exemption would not be available to a branch whose activities do not constitute the conduct of a trade. In this way, profits from a branch carrying on passive, investment character, activities remain fully subject to corporation tax in Ireland (subject to such credit relief as may be available for foreign taxes on the related income and gains).
- **Taxable presence** – The branch exemption would not be available where the branch is not recognised as a taxable presence in the branch jurisdiction i.e., the branch exemption would be available only where the profits of the branch can be said to be

subject to tax in the foreign jurisdiction. This threshold for the application of a branch exemption regime is consistent with hybrid mismatch measures that apply under ATAD in respect of branches.

- **Income and gains** – The branch exemption should extend to all branch trading profits whether in the character of income or capital gains arising to the branch e.g., would include capital gains arising on the disposal of assets held by the branch or upon a sale or cessation of the branch business. This would eliminate a difference between the existing treatment of a branch and a subsidiary in equivalent circumstances.
- **Cessation and post cessation receipts** – The branch exemption should apply to profits arising on sale of the branch business or on the unwind or cessation of the branch's business, as well as post cessation trading related receipts.
- **No foreign tax relief** – Relief should not be available for foreign taxes on branch profits where the exemption regime applies.
- **Election basis** – We recommend that the taxpayer should be eligible to make a revocable election for the branch exemption to apply on a branch-by-branch basis. This could mean that, even post adoption of the regime, existing and new branches could remain taxed in Ireland on a worldwide basis should the company choose not to make an election for a branch exemption in respect of those branches.
- **Losses** – In circumstances where branch losses have been used to obtain Irish tax relief, a branch exemption for profits would not be available until such time as the taxable amount of branch profits equals the amount of Irish taxable profits which have been reduced using branch losses. This rule should also apply to losses emerging prior to the introduction of the regime (see detailed comments on this in Transitional Arrangements section below). This is with the exception of any 'final' and otherwise unused losses arising on the 'liquidation' or unwind of the foreign branch. In accordance with EU case law precedents[3] such losses should remain available for use against Irish profits.
- **Transparent entities** – In circumstances where a taxpayer conducts a business through a transparent entity such as a partnership and the business gives rise to a taxable branch presence abroad, it would be helpful to provide certainty that the corporate partner can avail of the branch exemption on its share of the foreign branch profits.

Substantial shareholding exemption

- **Qualifying jurisdiction** – Aligned with the dividend participation exemption, the list of jurisdictions eligible for the substantial shareholding exemption should be expanded.

  For companies within scope of GloBE / EU rules on minimum tax:

  To align with the OECD BEPS 2.0 Pillar Two GloBE rules as applied within the EU, which will see all profits, irrespective of location, being taxed at a minimum rate via the Income Inclusion or Under-taxed Payment Rule, companies within scope of the GloBE rules should be eligible for the substantial shareholding exemption irrespective of the location of the company.

[3] This is in line with the principles for cross border relief for losses in the case of Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes) C-446/03.

For companies not within scope of GloBE / EU rules on minimum tax:

In order to be sufficiently attractive as compared to the regimes in place in other countries, whilst the list of qualifying countries should include all EEA countries and our Treaty partners, it should be far wider than this. It should extend to all jurisdictions except those included on the EU non-cooperative list.

If the list is to be confined further, it could include EEA countries and our treaty partners alongside;

- all countries that have signed up to the Convention on Mutual Administrative Assistance in Tax Matters excluding those on the EU non-cooperative list
- all countries in the Inclusive Framework who have signed up to the OECD BEPS 2.0 Pillar Two Plan, provided the countries are not on the EU non-cooperative list

In determining the 'location' of the company, this should be linked to where the company is either resident, managed and controlled or incorporated. Confining the list to those tax resident in a jurisdiction results in several jurisdictions not being eligible as they do not have a concept of tax residence. Instead, they may tax by reason of domicile, place of management, incorporation or any other criterion of a similar nature. Often countries with an exclusively territorial tax regime will not have adopted a concept of tax residence.

- **No trading test requirement** – We consider that a trading test should no longer be a requirement to be eligible for the exemption. Existing anti-avoidance measures, including access to tax treaties, CFC charge, the OECD BEPS 2.0 minimum effective tax rate, transfer pricing, GAAR etc. afford the protections to guard against tax avoidance transactions. We note that internationally, several jurisdictions operate their exemption without a trading test.
- **Holding period** – Any holding period requirement should be aligned with the holding period requirement in the participation exemption. Clarity that the substantial shareholding exemption will apply from the date of ownership provided the shares are ultimately held for the minimum holding period will be important.

3. Interaction with CFC Rules

Question 8

Please outline your view of whether Ireland's CFC rules would be adequately aligned with participation exemption and/or branch exemption regimes should these be introduced. What synergies or risks, if any, do you foresee arising?

Question 9

Please identify any particular design features of these exemption regimes that could have positive or negative impacts in this context? Please elaborate.

Question 10

Please identify any adaptations to Ireland's CFC rules that should be considered in conjunction with the introduction of such exemption regimes.

Amend the current CFC rules so that exempt foreign branches are within the scope of the CFC regime.

The CFC charge arises where a CFC has undistributed income, from non-genuine arrangements put in place for the essential purpose of avoiding tax, and relevant Irish activities (i.e., significant people functions (SPFs) or key entrepreneurial risk-taking functions (KERTs) in the State) are performed by an Irish resident company that controls the CFC (controlling company) or a company connected to the controlling company.

In order to align the current CFC rules with the Anti-Tax Avoidance Directive (ATAD), Section 835I, Taxes Consolidation Act 1997 should be amended to provide that foreign branches availing of the foreign branch exemption are potentially within scope of the CFC charge. By amending the CFC regime, it will protect against profits which would have been subject to a CFC charge if they were in a subsidiary being diverted to a branch in order to avail of the foreign branch exemption.

4. Interest Charges associated with Exempt Income

Question 11

In your view, should tax relief for funding costs of investments be reviewed, with a view to restrictions, if foreign income from such investments were to be exempted? What EU law or tax treaty constraints, if any, might impede such restrictions?

The corporate tax rules providing for a tax deduction for funding costs of investments should not be supplemented with any further restrictions.

For other reasons unrelated to the introduction of the participation exemptions, we continue to recommend that Ireland's corporation tax rules for deducting interest and other financial payments should be redesigned.

A deduction for the funding costs of investment should be available in recognition that the interest expense is a cost of doing business. Investing in a business either through the trade carried out by the company or through equity in another company carrying on a trade should be treated in a similar manner in recognition that the underlying profits of the business are taxable (whether in Ireland or abroad). This affords groups the flexibility to operate their businesses in different legal forms, through a branch or company. This is in line with the current tax provisions allowing for a tax deduction for funding costs of investments in Irish companies where dividend receipts are exempt Franked Investment Income under Section 129, Taxes Consolidation Act 1997.

We would be concerned that any provision which denies tax relief for financing costs with respect to investments on the basis that the investee company is established outside Ireland would be at risk of breaching the EU principle of free movement of capital. This risk would arise were such a restriction is implemented with respect to investments in companies within the EU, as well as third countries. Similarly, restricting relief for certain investments in companies established in other EU member states could result in a breach of the EU principle of freedom of establishment.

We would also note that to restrict tax relief for financing costs on investments the income or gains of which are not subject to Irish tax would be a significant and damaging departure from current policy in this area. We would note that no such restriction currently arises with respect to investments in subsidiaries where a future gain on disposal should not be subject to corporation tax on chargeable gains due to the availability of our CGT substantial shareholding exemption under Section 626B, Taxes Consolidation Act 1997. Similarly, no restriction currently arises on financing costs incurred on providing equity to a non-Irish subsidiary even where Irish tax is not expected to arise on the future receipt of dividends from that entity, for example due to the availability of foreign tax credit relief with respect to such dividend income.

The framework of the existing interest deductibility regime provides a strong basis for protection from base erosion. Hence, we recommend no further restrictions are introduced. In determining that no further restrictions are required, we outline below a list of existing provisions that mitigate risk of base erosion and profit shifting in respect of interest expenses;

In the case of interest expense potentially deductible in computing foreign trading branch profits:

- The borrowing must be incurred wholly and exclusively for the purposes of the trade,
- The expense must be revenue and not capital in character, and
- The loan arrangement must be priced on arm's length terms in accordance with OECD guidelines. The transfer pricing regime provides for upward adjustments only. There is no basis to deduct a notional expense by reference to a market rate of interest where the income is not taxed on the lender.

With respect to relief for funding costs of investment in shares, relief may be available where the interest qualifies as 'interest as a charge', in accordance with Section 247, Taxes Consolidation Act 1997. Interest deductible under the 'interest as a charge' regime is confined to interest solely when paid on borrowings to acquire a material interest in shares of companies which meet defined conditions and in lending to such companies. The conditions to avail of the relief which allow interest to be offset against current period taxable group profits are prescribed and complex. They must be met not just at the date of the borrowing but throughout the period that interest is paid on the loan. To protect against base erosion, the relief is denied for connected party borrowings used to acquire shares already held by connected persons; for circular lending arrangements; and for borrowings to fund loan advances unless there is equivalent additional income taxed in the Irish group. Disposals of any shareholdings or intra group debt trigger 'recovery of capital' measures which deny a deduction for 'interest as a charge' by deeming borrowings to be repaid (even if the financing is unrelated to the recovery event).

Overlaying these provisions, is the Interest Limitation Rule introduced in Finance Act 2021. This rule has added an additional layer of complexity for taxpayers seeking to claim a tax deduction for interest expenses. Including new interest restrictions will add layers of complexity where the risk of base erosion has already been addressed in the corporate tax regime.

In addition to the interest deductibility provisions outlined above, there are several other provisions in the Taxes Consolidation Act that seek to restrict or deny tax relief for interest expense. The substantial number of legislative provisions restricting interest deductions are cumbersome and complex to comply with. Both the taxpayer and Revenue would benefit from both reducing the number of provisions that apply and removing any provisions that are duplicitous in the type of transaction they seek to address. We reassert the point we made in previous KPMG submissions that in order to readjust the balance of protections from base erosion provided under Ireland's corporation tax regime, a redesign of Ireland's corporation tax regime for taxing interest and other financial payments should be undertaken.

5. Exit Tax

Question 12

Please outline what in your view the impacts, if any, of participation exemption and/or branch exemption regimes might be on Ireland's Exit Tax rules. Do you foresee any synergies or risks in this space?

Question 13

Please identify how particular design features of the exemption regimes could have positive or negative impacts in this context.

Ireland will need to amend its Exit tax rules to ensure transfers of assets from head office to a branch is within scope of the exit tax charge where a branch election is made.

Anti-Tax Avoidance Directive compliant Exit Tax rules was introduced in Finance Act 2018 and took effect from 10 October 2018. Article 5 of ATAD provides for four scenarios where the Exit Taxation rules apply, namely where a taxpayer:

1. transfers assets from a head office to a permanent establishment in another EU Member State or a third country in so far as the Member State of the head office no longer has the right to tax the transferred assets due to the transfer;
2. transfers assets from a permanent establishment in a Member State to its head office or another permanent establishment in another EU Member State or a third country in so far as the Member State of the head office no longer has the right to tax the transferred assets due to the transfer;
3. transfers its tax residence to another Member State or to a third country, except for those assets which remain effectively connected with a permanent establishment in the first Member State;
4. transfers the business carried on by its permanent establishment from a member State to another Member State or to a third country in so far as the Member State of the permanent establishment no longer has the right to tax the transferred assets due to the transfer.

As a result of Ireland's worldwide system of taxation, it was not necessary to include transfers of assets from an Irish head office to a foreign permanent establishment within the Exit Taxation rules on the basis that the assets are still within the Irish tax net (scenario 1 above).

If Ireland introduces a foreign branch exemption that extends to chargeable gains arising from assets used in the branch, it will mean that Ireland will no longer have the right to tax the asset that has been transferred to the permanent establishment. As such, it will be necessary to amend the transactions within scope of Section 627(2), Taxes Consolidation Act 1997 to include transfers of assets from an Irish head office to its EU branch or a third country branch that avails of the branch exemption. In scope transactions will result in an exit tax even where the asset has not been disposed to a third party. The exit tax should only arise where the foreign branch profit election has been made in respect of the receiving

branch. An option to elect on a branch-by-branch basis to not be within scope of the foreign branch exemption will be relevant for companies that will be not be in a position to a pay an exit tax liability. The branches that do not avail of the foreign branch exemption will continue to be taxable in Ireland and hence the exit charge should not apply on the transfer of assets by head office to these branches.

6. Schedule 24

Question 14

Do you believe that a review and simplification of Schedule 24 could be feasible and sufficient, instead of changing to participation exemption and/or branch exemption regimes? How might this simplification be achieved?

Question 15

What in your view are the relevant considerations in terms of any simplification of Schedule 24?

Question 16

In the event of Ireland moving to participation exemption and/or branch exemption regimes, what simplifications, if any, could be considered for the remaining credit system of double taxation relief - including in respect of foreign-source interest and royalty income and out-of-scope dividend, branch income and capital gains?

Ireland should overhaul its existing double tax credit regime in addition to introducing a participation exemption and foreign branch exemption. Simplification of the existing double tax credit regime alone will enhance Ireland's competitive offering.

Simplifying double tax relief for all sources of foreign income / gains

Outlined below is a list of measures that could be implemented to the Schedule 24, Taxes Consolidation Act 1997 provisions so as to simplify the application of Ireland's foreign tax credit regime:

- Rewrite the legislative measures which underpin the operation of the credit relief regime to make them easier to read and more straightforward to administer in practice.
- Remove the distinction between relief under a tax treaty and unilateral relief and provide a single mechanism for double tax relief.
- Extend the double tax relief provisions to apply to distributions on shares.
- Provides clarity on the scope of royalty payments that are eligible for the relief in the context of payments for services.
- Allow a carry forward of foreign tax credits where Irish tax on the underlying income has been deferred as a result of capital allowances.
- Provide legislative certainty to an entitlement to deduct excess and unused creditable foreign taxes under general principles.
- Ireland could also improve the competitiveness of its regime for double tax credit relief by enhancing its regime as follows .
  - calculating the net income measure (which operates to limit the amount of credit relief) by reference to net margins from the specific source of profits instead of by reference to the margins of the trade as a whole,
  - offsetting excess unused credits against other income of the trade, and
  - pooling surplus tax credits for use in future periods.

Simplifying double tax relief for foreign dividend income

In the case of the operation of credit relief for foreign dividends, the following simplifications are suggested:

- **Tracing dividend resolutions** - Permit taxpayers to track and attribute tax credits related to dividends solely by reference to a taxpayer election which is not required to be mirrored in dividend resolutions based by the paying company.

  One of the greatest difficulties arising in the practical administration of the current credit relief system is aligning dividend declaration resolutions under foreign law with Irish foreign tax credit tracing requirements which may not always be straightforward (or indeed possible) to achieve under local law. The tracking of the dividend source and related tax credits should simply be a matter of a taxpayer election with no requirement to link the source of the dividend for Irish tax purposes to declarations of dividends under foreign law. In many cases, there is no requirement under foreign law to identify the source of the profit from which the dividend is paid i.e., it is simply required that there are adequate profits available for distribution.

- **FII case update** - Updating the manner of operation of paragraph 9I, Schedule 24, Taxes Consolidation Act 1997 ('para 9I') to reflect evolving case law insights from the UK courts[4] on the interpretation of the decision handed down in the FII case[5]. The findings in this case required Ireland to introduce the provisions in para 9I in order to conform the Irish corporation tax treatment of dividends from Irish resident and non-resident sources.

- **Priority application of para 9I** - Simplifying the operation of double tax credit relief for cases within scope of the relief under para 9I by providing that the credit relief which applies by reference to the rate of tax in the country where the dividend profits have been subject to tax would apply first, before the application of double tax credit relief which would otherwise apply.

  In this way, a company which is entitled otherwise to credit relief under applicable relief provisions would not have to first apply standard credit relief rules to establish the tax relief otherwise due and then 'top up' the credit relief by making a claim to additional relief under para 9I. The relief under para 9I is capped at the level of Irish tax attributable to the dividend. This change in the manner of operation of the relief should not, in practice, change the measure of overall relief given.

  In cases where sufficient credit relief is available under para 9I to offset in full the measure of Irish attributable tax, the taxpayer could simply claim first the relief under para 9I without the requirement to first calculate the relief otherwise available.

- **Simplify tracing profits** - Simplify the current requirement to trace profits moving through intermediary layers of companies over many years by allowing taxpayers to operate and apply a pooled basis of double tax credit relief for a holding company and its subsidiaries. In this way, taxpayers need not maintain records over many years tracking the past history of dividends and the financial years to which they relate but would simply calculate the effective tax rate on the profits of the pooled companies with each successive dividend from that pool having the same effective foreign tax credit rate.

---

[4] Test Claimants in FII Group Litigation v HMRC [2016] EWCA Civ 1180 reviews the UK application of the CJEU decision in this case to foreign dividends received when the UK's taxation of dividends was similar to Ireland's current regime. The case has passed to the Supreme Court. A linked case, Six Continents Overseas Holdings Limited & CIR [2016] EWHC 2426 (Ch), has passed the Court of Appeal stage.

[5] Test Claimants in FII Group Litigation v Commissioners of the Inland Revenue, C-446/04.

Simplifying double tax relief for branch profits

We suggest that Ireland could amend the operation of double tax relief for taxes on foreign branch profits as follows:

- **Excess foreign tax** - Confirm by legislative amendment that corporate income tax paid on branch profits which is in excess of the Irish capacity to absorb credit relief e.g., because of losses in the Irish company as a whole, is available as an expense deduction (under Section 81, Taxes Consolidation Act 1997) in like manner to any other business expense incurred in conducting the trade.
- **Pooling of foreign tax credits** - Amend the calculation of the unrelieved foreign tax in paragraph 9FA, Schedule 24, Taxes Consolidation Act 1997 ('para 9FA') to ensure that credit relief is available for foreign taxes on branch profits on a pooled basis in a manner which is understood to be aligned with the policy intent. The intention of para 9FA is to allow the carry forward of unused foreign tax credits on the profits of branches. It is intended to achieve foreign tax credit pooling for branches. However, following the amendment of paragraph 7(3)(c), Schedule 24, Taxes Consolidation Act 1997 by Finance Act 2013, the provisions of para 9FA do not achieve this in a situation where foreign tax is paid on the profits of a foreign branch but there are tax adjusted losses for Irish tax purposes.
- **Foreign tax on branch losses** - Para 9FA provides for the pooling and carry forward of excess foreign tax credits. Based on the formula in para 9FA(2)(a), the excess foreign tax credits available for pooling and carry forward in the period are calculated by reference to the expense deduction allowed for the foreign tax in question under paragraph 7(3)(c), Schedule 24. The Finance (No. 2) Act 2013 amendments to paragraph 7(3)(c) sought to clarify that the expense deduction available is limited to the Irish measure of the foreign income. However, their operation in the context of the provisions of para 9FA means that where no expense deduction is available in that period it follows that there is no excess foreign tax available for pooling or carried forward credit relief.

  It is not unusual for a foreign branch to pay foreign tax on its profits where the Irish measure of the branch profits is a loss. In these circumstances, no expense deduction is available for the foreign tax and no tax credit is available for pooling relief and carry forward to a future period for relief. This can lead to double taxation and is at odds with the stated intention of para 9FA which is to treat foreign branches as a single pool and allow the carry forward of unused foreign tax credits.

  This can be rectified by amending the formula in para 9FA(2) so that the credit available for pooling is calculated by reference to the foreign tax paid in respect of the branch rather than the foreign tax for which an expense deduction is available under paragraph 7(3)(c).

Simplifying double tax relief for royalty income

We do not suggest that Ireland should move to adopt a territorial regime and exempt from tax foreign royalty receipts. In like manner to the taxation of foreign branch profits and foreign dividends, the operation of credit relief on foreign royalties is a combination of tax credit relief and expense deduction relief which are provided under double tax treaties and well as under unilateral relief provisions that are set out at Schedule 24, Taxes Consolidation Act 1997. In broad terms, the outcome of the Irish credit relief and expense relief measures is that additional Irish tax is not payable on the royalty income where the amount of foreign taxes borne on royalty income which is received in the course of the trade of the Irish

taxpayer is greater than the Irish tax on the Irish measure of the net taxable royalty income (estimated by reference to the net taxable income of the trade taken as a whole).

In order to expand their export led business operations, Irish based companies which operate in the services sector (particularly where services e.g., software services, derive from the exploitation of underlying intellectual property) are encountering tax regimes in counterparty countries which impose withholding taxes at source on payments which they consider to be in the character of royalties. Although Ireland's network of double tax treaties works to reduce the scope and rate of source country withholding taxes which can be applied by counterparties resident in tax treaty jurisdictions, not all tax treaties provide for a zero rate of withholding tax on royalties and not all new counterparty jurisdictions where the company is seeking to do business will have a tax treaty with Ireland to remove the cost to the company of the local withholding tax.

For companies with losses or smaller levels of profits and therefore do not have the capacity to offset foreign tax against Irish corporation tax, as a credit, we recommend that they have certainty that relief in the form of an expense deduction in measuring profits of the trade is available for foreign taxes. This is because such taxes form part of the cost to the company of doing business in that foreign market.

In addition, for those companies who can claim capital allowances on the assets from which they earn royalties, it is often the case that some or all of their taxable profits from those royalty streams are captured through balancing charges i.e., the taxable royalty income is sheltered by capital allowances but as Ireland's capital allowances regime often grants allowances at a rate faster than commercial depreciation of the assets, many of those allowances are effectively clawed back on a disposition of the asset. In reality, therefore, the royalty profits are only temporarily sheltered, and they are effectively taxed when the asset is sold. Under the current rules, credit for foreign taxes cannot be taken against these balancing charges even though they economically represent the royalty income rather than any true gain on sale.

Consequently, we recommend that the rules are amended to allow a carry forward of foreign tax credits where Irish tax on the underlying income has been deferred as a result of capital allowances.

7. Interaction with Anti-Hybrid rules

Question 17

Please outline how territorial participation exemption and/or branch exemption regimes could impact on Ireland's Anti-Hybrid rules. Do you foresee any synergies or risks arising from the change?

Question 18

Please identify any specific design features of exemption regimes that could have positive or negative impacts in this context? Please elaborate.

Question 19

Please identify any adaptations to Ireland's Anti-Hybrid rules that should be considered in conjunction with a transition to such exemption regimes.

It is important that Ireland retains the Anti-Hybrid rules if a branch and participation exemption is introduced in Ireland. We do not consider that additional rules are required.

The first and most significant element of the anti-hybrid rules was introduced in Finance Act 2019. The remaining element, dealing with reverse hybrid mismatches was introduced in Finance Act 2021 and came into effect on 1 January 2022.

The purpose of anti-hybrid rules is to prevent arrangements that exploit the differences in the tax treatment of an instrument or entity arising from the way in which that instrument or entity is characterised under the tax laws of two or more territories to generate a tax advantage or a mismatch outcome. The anti-hybrid rules afford protection to the Exchequer if a foreign branch exemption or a participation exemption is introduced.

Double Deduction (DD)

It was noted that the double deduction hybrid rules contained in the Anti-tax avoidance rules could in practice give rise to double taxation in respect of economically the same profits. A double deduction mismatch outcome arises to the extent a payment or part of a payment is tax deductible in two jurisdictions against non-dual inclusion income. Whilst economically the same income is taxed twice, the exact same income is not taxed twice and hence, falls within scope of the double deduction rules.

Section 835AB, Taxes Consolidation Act 1997 'Worldwide system of taxation' was introduced to ensure that double taxation in respect of economically the same profits does not arise. It neutralises potential double deduction mismatch outcome that could arise as a result of a "disregarded payment" between an Irish head office and its permanent establishment. This provision can apply where there is an Irish company with a foreign branch or where there is a foreign company with an Irish branch. These provisions continue to be relevant for those that do not elect for a foreign branch exemption or for companies resident in another jurisdiction with a worldwide taxation regime that have an Irish branch.

Where the foreign branch is exempt under Irish rules, there will be no tax expense deduction available in Ireland and therefore, the entity will not be in scope of the double deduction provisions.

Disregarded Permanent Establishment (PE)

Under the disregarded PE rules a tax deduction for cross border payments from a head office to branch are denied where the payment is not taxable by the branch. Similarly, this provision applies on payments from branch to head office, between branches or between associated parties. The disregarded permanent establishment ("PE") measures operate to deny a deduction in Ireland where Ireland is the payer jurisdiction. The rules will also apply so that Ireland will tax the profits of any Irish branch of a non-resident company where the profits of the branch are not included in the head office territory and the profits are not taxable in Ireland.

Deduction without Inclusion (D/NI)

A deduction without inclusion mismatch outcome arises to the extent a payment, or part of a payment, is tax deductible in one jurisdiction without a corresponding amount being included in another jurisdiction. As noted in earlier sections of this submission, the participation exemption should not be available where the payor is entitled to a tax deduction in respect of the distribution. On the basis that the domestic rules will be amended to provide that payments from an exempt foreign branch to an Irish head office are taxable, deduction non-inclusion outcomes should not arise in this regard.

8. Interaction with the Two-Pillar Solution

Question 20

Do you foresee potential impacts, arising from moving to participation exemption and/or branch exemption regimes, for the way in which the two pillar solution is implemented in Irish tax law? Are there any potential synergies or risks with the implementation of the two-pillar solution and such exemption regimes?

The introduction of a participation exemption and foreign branch exemption into Ireland's corporation tax regime is consistent with the GloBE Pillar Two provisions. Aligning these rules will aid and assist both the taxpayer and Revenue in administering and complying with both regimes.

Excluding dividends and foreign branch profits from the minimum effective tax rules recognises that the underlying profits of the business are being taxed at the minimum rate and as such, to not exempt them, would give rise to double taxation.

Pillar Two proposes a global minimum effective tax rate of 15% for in scope multinational enterprises (MNEs). On 20 December 2021, the OECD / G20 Inclusive Framework on BEPS involving 137 countries issued detailed rules for the Pillar Two global minimum effective tax rate of 15%. On 22 December 2021, a draft EU implementing Directive was released outlining the new Global Anti-Base Erosion (GloBE) as contained in the OECD Pillar Two proposals. It is this Directive which, if it enters into force, will ultimately be transposed into Irish domestic legislation. The comments below are based on the details contained in these documents.

In calculating the global minimum effective tax rate (ETR), the GloBE rules provide that the ETR is calculated on a jurisdiction-by-jurisdiction basis. The ETR is calculated based on the covered taxes divided by the GloBE Income. If this is less than 15%, the difference is collected by way of a top-up tax.

Participation Exemption and Substantial Shareholding Exemption

In assessing GloBE income, the rules under the OECD and the draft EU Directive provide that 'excluded dividends' and 'excluded equity gain or loss' are excluded in the calculation of the ETR and is not subject to any additional top-up tax.

Under the OECD proposals, 'Excluded dividends' is defined as dividends or other distributions received or accrued in respect of an Ownership Interest, except for: (a) a Short-term Portfolio Shareholding [accrued for less than 1 year], and (b) an Ownership Interest in an Investment Entity that is subject to an election under Article 7.6. [taxable distribution method – not relevant in Ireland]. A participation exemption as outlined in our submission will broadly align with the definition of 'excluded dividends' for GloBE. This will align the taxation

of foreign dividends under the current Irish tax regime with those under the GloBE rules contained in Pillar Two.

Under the OECD proposals, 'Excluded equity gain or loss' is defined as gain, profit or loss from: (a) gains and losses from changes in fair value of an Ownership Interest, except for a Portfolio Shareholding; (b) profit or loss in respect of an Ownership Interest included under the equity method of accounting; and (c) gains and losses from disposition of an Ownership Interest, except for a disposition of a Portfolio Shareholding.

Portfolio shareholding are defined as less than 10% ownership. Whilst the current substantial shareholding exemption provides for a 5% ownership requirement, for those in scope of GloBE, where the requisite 10% ownership is met, the gains will be outside the GloBE top-up tax. It is important to note that no further criteria, such as the trading test or source jurisdiction is required under GloBE for the disposal of shares to be considered an 'excluded equity gain or loss'. Amending the substantial shareholding exemption in line with our suggestions will further align the taxation of disposal of shares under the current Irish tax regime with those under the GloBE rules contained in Pillar Two.

Where covered taxes arise in respect of either 'excluded dividends' or 'excluded equity gain or loss', they must be removed from the ETR calculation. As such, providing an exemption for these will simplify the calculation of the GloBE rules for in scope MNEs by removing the necessity to identify and remove any covered taxes in respect of these income items.

Foreign branch exemption

Under the GloBE income rules, the income of the branch is attributed to the jurisdiction in which the branch is located. Therefore, any top-up tax due in respect of the branch is payable in the jurisdiction in which it is located. The income of the branch is not included in the jurisdiction of the head office under the GloBE rules. A foreign branch exemption will align the Irish corporate tax rules with the GloBE rules, providing that the tax should arise in the jurisdiction in which the branch is located.

9. Ireland's Double Taxation Treaty Network

Question 21

Do you foresee potential impacts, arising from moving to participation exemption and/or branch exemption regimes, for Ireland's tax treaties?

Question 22

Should the renegotiation of Ireland's tax treaties, as respects the *Elimination of Double Taxation* article, be considered in the event of the enactment of participation exemption and/or branch exemption regimes? Would this be necessary? If so, how might it be feasible to accomplish this in a targeted and efficient manner?

Question 23

Would any amendment of Ireland's worldwide tax system to allow for exemption of foreign dividends, gains or branch income necessitate a review of specific tax treaties in Ireland's network, where previously Ireland's worldwide charge would have ensured taxation of such dividends, gains or branch income? Alternatively, could such taxation be ensured by limiting the scope of any exemptions enacted in domestic law?

A participation exemption and a foreign branch exemption can be introduced solely through changes in domestic legislation alone. Save for possibly having to adopt Article 10 of the Multilateral Instrument in respect of foreign branches, no changes would be required to our treaties as the exemptions would not give rise to income being taxed in both countries. In order to avoid having to potentially adopt Article 10, we recommend that the Irish foreign branch exemption is only available to trading branches.

Branch exemption

The *Business Profits* article of Irish treaties allocates taxing rights in respect of profits of a permanent establishment to the jurisdiction where the permanent establishment is located. Under Ireland's worldwide system of taxation, the profits of the permanent establishment are also taxed in Ireland, with a credit available for the tax paid in the jurisdiction of the permanent establishment up to the Irish measure as calculated under Schedule 24, Taxes Consolidation Act 1997.

The double taxation of branch profits arises as a result of Ireland's worldwide system of taxation as provided for under domestic legislation[6]. Therefore, the introduction of a foreign branch exemption can be achieved through the amendment of domestic legislation. The

[6] Section 18, Taxes Consolidation Act 1997

introduction of a foreign branch exemption in this manner should not necessitate the renegotiation of Irish tax treaties as the exemption will not give rise to double taxation.

Ireland reserved its right to the entirety of Article 10 'Anti-abuse Rule for Permanent Establishment Situated in Third Jurisdictions' of the Multilateral Instrument to not apply to its Covered Tax Agreements. This article seeks to deny tax treaty benefits where branch income benefits from treaty access of the head office's State of residence but a preferential regime results in branch tax rate of less than 60% of the tax rate in the treaty State. This could arise if Ireland introduces a foreign branch exemption, and the branch profits are taxed at a rate of less than 60% of the relevant Irish rate. However, this article does not apply where the income arises from a branch carrying on an active business or for branch royalties where the Intellectual Property was developed by the branch. In order to avoid having to potentially adopt Article 10, we have recommended that the Irish foreign branch exemption is only available to trading branches.

Dividend Participation exemption

The *Dividends* article of Irish treaties, generally, provide that dividends may be taxed in the payee jurisdiction and also taxed in the payor jurisdiction in the form of a withholding tax. Where the dividends are doubly taxed, the *Elimination of Double Taxation* article provides for a credit against Irish taxes in respect of taxes paid in the payor jurisdiction. Where a participation exemption in respect of foreign dividends applies, the dividends are not doubly taxed as the dividends are exempt in Ireland. Therefore, the *Elimination of Double Taxation* article should not apply in this regard. As such the participation exemption can be introduced through the amendment of domestic legislation.

Credit mechanism under tax treaties

For classes of income that will still need to rely on the credit mechanism, no changes will be required to our treaties on foot of the implementation of the exemption as our treaties, as explained below, already contain adequate protection to deal with treaty shopping and base erosion.

Ireland's tax treaties provide for the elimination of double taxation through the credit method, i.e., to the extent that the income, profits or gains are taxed in both Ireland and the counterparty jurisdiction, a credit would be available in Ireland, against the relevant Irish taxes, in respect of the taxes charged in the counterparty jurisdiction.

The Multilateral Instrument overlays additional requirements in covered tax treaties affording protection against base erosion. Ireland selected to adopt the preamble and a principal purposes test from the Multilateral Instrument into its covered tax treaties. The preamble provides that the stated intention of the tax treaty is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements. The principal purposes test denies benefits under the tax treaty if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of the transaction.

In addition to the above, most of our tax treaties require the company to be 'liable to tax' to be considered a resident of a contracting State under the tax treaty and avail of treaty benefits. This provides a layer of protection, requiring parties seeking to rely on articles contained in the tax treaty to be liable to tax.

10. Transitional Arrangements

Question 24

Do you foresee impacts in relation to the matters identified above or any other matters related to transitional arrangements?

Foreign Branch exemption – losses

As a transitional measure in moving to the adoption of a branch exemption regime it is suggested that in circumstances where branch losses have previously been used to obtain Irish tax relief, it may make sense to provide that a branch exemption would not be available until such time as the taxable amount of branch profits equals the amount of Irish taxable profits which have been reduced using branch losses.

Similar measures should also apply in the event that an elective branch exemption regime is adopted for new branches established after the regime is in place, i.e., a taxpayer that wishes to make an election for a branch exemption can only avail of the exemption where losses associated with the branch have been equalled by taxable branch profits.

These provisions also envisage that the rules would be applied on a branch-by-branch basis, rather than treating all foreign branches as a single branch for Irish tax purposes. This aligns more closely with the treatment of subsidiaries as different taxable entities. It also allows for the targeted application of a CFC rule to a single branch, the clearer separation of non-trading activities and the proper allocation of losses under the transition rules.

11. Other Issues

Question 25

In your view, what other relevant considerations should be taken into account? You may wish to consider this question in the context of the recent OECD Inclusive Framework Two-Pillar agreement.

We refer to our earlier comments in section 8 of this submission.

kpmg.ie

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2022 KPMG, an Irish partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are registered trademarks of KPMG International Limited ("KPMG International"), a private English company limited by guarantee.